MULTIMEDIA UNIVERSITY

STUDENT IDENTIFICATION NO

MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2016/2017

BAC3654 – PROFESSIONAL ETHICS

(All sections / Groups)

12 OCTOBER 2016
2.30p.m – 5.30p.m
(3 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of **6** pages with **4** Questions only.

2. Attempt **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.

3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

Coastal Oil is one of the world's largest petrochemical companies. It is based in Deeland and is responsible alone for 10% of Deeland's total stock market value. It employs 120,000 people in many countries and has an especially strong presence in Effland because of Effland's very large consumption of oil and gas products and its large oil reserves. Coastal Oil is organised, like most petrochemical companies, into three vertically integrated business units: the exploration and extraction division, the processing and refining division, and the distribution and retailing division.

Because of the risks and the capital investment demands, Coastal Oil has joint venture (JV) agreements in place for many of its extraction operations (i.e. its oil and gas rigs), especially those in the deep-water seas. A JV is a shared equity arrangement for a particular project where control is shared between the JV partners. In each of its JVs, Coastal Oil is the largest partner, although operations on each rig are divided between the JV member companies and the benefits are distributed according to the share of the JV.

As a highly visible company, Coastal Oil has long prided itself on its safety record and its ethical reputation. It believes in supporting shareholder value. Its corporate code of ethics, published some years ago, pledges its commitment to the 'highest standards' of ethical performance in the following areas: full compliance with regulation in all jurisdictions, safety and care of employees, transparency and communication with stakeholders, social contribution, and environmental responsibility. In addition, Coastal Oil has usually provided a lot of voluntary disclosure in its annual report and on its website. It says that it has a wide range of stakeholders and so needs to provide a great deal of information.

One of the consequences of dividing up the different responsibilities and operations on an oil or gas rig is that Coastal Oil does not have direct influence over some important operational controls. The contractual arrangements on any given oil rig can be very complex and there have often been disagreements between JV partners on some individual legal agreements and responsibilities for health and safety controls. Given that Coastal Oil has JV interests in hundreds of deep-water oil and gas rigs all over the world, some observers have said that this could be a problem should an accident ever occur.

This issue was tragically highlighted when one of its deep-water rigs, the Effland Coastal Deep Rig, had an explosion earlier this year. It was caused by the failure of a valve at the 'well-head' on the sea floor. The valve was the responsibility of Well Services, a minor partner in the JV. Eight workers were killed on the rig from the high pressure released after the valve failure, and oil gushed into the sea from the well-head, a situation that should have been prevented had the valve been fully operational. It was soon established that Well Services' staff failed to inspect the valve before placing it at the well-head at the time of installation, as was required by the company's normal control systems. In addition, the valve was attached to a connecting part that did not meet the required technical specification for the water depth at which it was operating. The sea bed

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was 1,000 metres deep and the connecting part was intended for use to a depth of up to 300 metres. There was a suggestion that the need to keep costs down was a key reason for the use of the connecting part with the inferior specification.

Reports in the media on the following day said that the accident had happened on a rig 'belonging to Coastal Oil' when in fact, Coastal Oil was technically only a major partner in the joint venture. Furthermore, there was no mention that the accident had been caused by a part belonging to Well Services. A journalist did discover, however, that both companies had operated a more lax safety culture on the deep-water rigs than was the case at facilities on land (the 'land-side'). He said there was a culture of 'out of sight, out of mind' on some offshore facilities and that this meant that several other controls were inoperative in addition to the ones that led to the accident. Information systems reporting back to the 'land-side' were in place but it was the responsibility of management on each individual rig to enforce all internal controls and the 'land-side' would only be informed of a problem if it was judged to be 'an exceptional risk' by the rig's manager.

The accident triggered a large internal argument between Coastal Oil and Well Services about liability and this meant that there was no public statement from Coastal Oil for seven days while the arguments continued. Lawyers on both sides pointed out that liability was contractually ambiguous because the documentation on responsibilities was far too complex and unclear. And in any case, nobody expected anything to go wrong. In the absence of any official statement from Coastal Oil for those seven days, the media had no doubts who was to blame: Coastal Oil was strongly criticised in Effland with the criticism growing stronger as oil from the ruptured valve was shown spilling directly into the sea off the Effland coast. With no contingency plan for a deep-water well-head rupture in place, the ruptured valve took several months to repair, meaning that many thousands of tonnes of crude oil polluted the sea off Effland. Images of seabirds covered in crude oil were frequently broadcast on television and thousands of businesses on the coast reported that the polluted water would disrupt their business over the vital tourist season. Public statements from Coastal Oil that it was not responsible for the ruptured valve were seemingly not believed by the Effland public. Senior legislators in Effland said that the accident happened on 'a rig belonging to Coastal Oil' so it must be Coastal Oil's fault.

A review by the Coastal Oil board highlighted several areas where risk management systems might be tightened to reduce the possibility of a similar accident happening again. The finance director, Tanya Tun, suggested that the company should disclose this new information to shareholders as it would be value-relevant to them. In particular, she said that a far more detailed voluntary statement on environmental risk would be material information to the shareholders. The annual report would, she believed, be a suitable vehicle for this disclosure.

Because of the high media profile of the event, politicians from Effland involved themselves in the situation. Senator Jones's constituency on the coast nearest the rig was badly affected by the oil spill and many of his constituents suffered economic

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loss as a result. He angrily retorted in a newspaper interview that Coastal Oil's CEO, Mrs Ahmed,'should have known this was going to happen', such was the poor state of some of the internal controls on the Effland Coastal Deep Rig.

As the oil spill continued and the media interest in the events intensified, CEO Mrs Ahmed was summoned to appear before a special committee of the Effland national legislature 'to explain herself to the citizens of Effland'. The Coastal Oil board agreed that this would be a good opportunity for Mrs Ahmed to address a number of issues in detail and attempt to repair some of the company's damaged reputation. The board agreed that Mrs Ahmed should provide a full statement on the internal control failures to the special committee.

(Case adopted: ACCA Global)

a. Describe **5 (five)** benefits of a corporate code of ethics.

(5 marks)

b. Coastal Oil appears to have failed its own code of ethics. Describe **5 (five)** failures of the company against its own stated ethical aims as set out in its code of ethics.

(5 marks)

c. CEO Mrs Ahmed has been informed that she will be asked to explain the causes of the accident to the audit committee. Prepare a statement for Mrs Ahmed that explains the following:

   i. The description on **5 (five)** internal control failures that gave rise to the accident;

   (10 marks)

   ii. 'Health and safety' risk and the **2 (two)** factors that can increase this risk in an organisation.

   (5 marks)

[TOTAL 25 MARKS]

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QUESTION 2

Jojo Auditors is an audit practice with five partners. The five partners have worked together for several years and, as well as being work colleagues, are personal friends with each other. At Jojo it is customary for the performance of all student accountants to be appraised after their first year of a training contract using a range of criteria including examination success, technical ability and professionalism. Three levels of outcome are possible:

1. 'Good', allowing students to continue with no issues;
2. 'Some concerns', meaning students are counselled and then allowed to continue; and,
3. 'Poor', where students are dismissed from the audit practice.

The appraisal committee comprised of three people: managing partner Jack Hu, the training manager (both of whom are professional accountants) and the person responsible for human resources. The committee receives confidential reports on each student and makes decisions based on the views of relevant engagement partners and also exam results. It is normally the training manager who makes the recommendation and in most cases his appraisal is agreed and then acted upon accordingly. Because the appraisals are confidential between the student and the firm, the list of students and their appraisal categories are not publicised within the firm.

When the 2010 intake was being appraised last year, one student was appraised by the training manager as 'poor' but was not dismissed. Polly Shah was unpopular among other students because she was considered lazy and technically weak. She also failed a number of her exams. Other students who were appraised as 'poor' were dismissed, but Polly received a brief counselling session from Jack Hu and then returned to her duties. Polly stayed for another year and then, having failed more exams, left Jojo to pursue other career interests outside accounting.

Polly's departure triggered some discussion amongst Jojo's partners as to why she had been retained when other poor performers had not. It later emerged that Jack Hu was a close friend of Polly's parents and had enjoyed free holidays in the Shah family's villa for several years. Because he was the managing partner, Mr Hu was able to insist on retaining Polly, despite the objections of the training manager and the human resources representative, although the training manager was reported to be furious at the decision to retain Polly.

(Case adopted: ACCA Global)

a. Define 'conflict of interest' and assess the **4 (four)** consequences of Jack Hu's appraisal on Polly Shah.

(9 marks)

b. Describe **4 (four)** actions that could be applied in Jojo to prevent a recurrence of the events like those described in the case.

(8 marks)

c. "The case raises issues of the importance of senior management performance measurement. In a public company, this refers to directors, and in a privately-owned partnership like Jojo, it refers to partners. The managing partner (Mr Hu's position) is equivalent to the role of chief executive".

Explain **4 (four)** criteria used in the performance measurement of individual directors and discuss **4 (four)** reasons why individual performance measurement of partners may be difficult to implement at Jojo.

(8 marks)

[TOTAL 25 MARKS]

QUESTION 3

You are employed as an accountant in a public listed company. You and the finance manager both report to the finance director. During tea time, the finance manager said that she had not been disclosing certain things to the auditor. You are not sure whether to believe this but are uneasy, as the culture appears to be one of "getting away with as much as possible". During your work, you overhear the accounts clerk saying about a bribe was paid to the foreign agent to secure a sales contract. You are uneasy about the situation and you are also worried that a close relationship between the finance manager and the finance director may prevent you from exploring the accuracy of the statements given to you.

a. Identify three (3) values to discharge duties and maintain rights of the accounting profession.

(6 marks)

b. Based on the above scenario, propose the possible course of action to the accountant.

(10 marks)

c. Bribery is a common ethical issue faced by many companies. Discuss this issue based on utilitarian, deontology and virtue ethics.

(9 marks)

[TOTAL 25 MARKS]

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QUESTION 4

Audit Committee play a vital role in assisting the Board of Directors of an insurer (the board) in the discharge of its responsibilities. In particular, the Audit committee play an important role in ensuring the integrity and transparency of the financial reporting process. Audit committee shall have the authority to engage independent counsel or advisors, as it determines necessary to carry out its duties.

a. Define 'independence' in the context of audit committees, and explain how audit committee members act with independent to the discharge their responsibilities.

(10 marks)

b. "The role of the audit committee as a central pillar of effective corporate governance and in the best position to provide effective oversight of the performance, independence and objectivity of the external auditor and the quality of the audit.

We believe that there are ways to build on their role and we support the introduction of a periodic comprehensive review of auditor performance and quality of the audit by the audit committee"

(Malaysia Institute of Certified Public Accountants)

Audit committee members are required to maintain an independence relationship with the company's external auditors'. Discuss **3 (three)** initiatives to maintain this relationship.

(9 marks)

c. The audit committee should also provide advice to the board on the independence of external auditor. Briefly discuss **3 (three)** advice that audit committee may provide on the quality of auditor's independence.

(6 marks)

[TOTAL 25 MARKS]

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